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Intelligence Memorandum

India: Prospects For Private Foreign Investment

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1971

INTELLIGENCE MEMORANDUM

INDIA: PROSPECTS FOR PRIVATE FOREIGN INVESTMENT

Introduction

1. Since Independence in 1947, India's government policy has hampered the inflow of private foreign investment. More recently, private foreign investors have been faced with increased restrictions. Many foreign firms in existence at Independence have not expanded but have repatriated capital in reaction to New Delhi's demands for Indianization, unfavorable wage and price policies, and uncertainties about future policies of a government ostensibly committed to socialism and an expanded public sector. Moreover, bureaucratic delays and mounds of red tape have frustrated many potential foreign investors, sharply restricting the flow of private capital into new ventures. This memorandum evaluates the prospects for private foreign investment in India in the light of past performance, government policies, and investment opportunities.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

Discussion

Private Foreign Investment Since Independence

2. In 1948 the book value of direct private foreign investment[1] in India was about $450 million,[2] or about one-third of the economy's industrial capital assets. Foreign capital was concentrated in export-oriented industries and related services, especially exports destined for the investor's home market. One-fifth of foreign investment was in tea plantations, over two-fifths in service activities – principally foreign trade – and over one-fourth in manufacturing, mainly jute. Less than one-tenth was in the petroleum industry, which serviced predominantly the domestic market. Moreover, foreign companies dominated those industries in which they invested. About 40% of all foreign trade was handled by foreign firms and two-thirds of this trade was financed by foreign banks. More than four-fifths of the area planted to tea and two-thirds of tea exports, over three-fourths of the jute industry, and one-half of the coal industry were under foreign control.

3. Branch offices were the predominant form of foreign investment at that time (see Table 1), and foreign control rested not only on ownership but also on a unique system of business organization – the managing agency. Such agencies administered British investment, which included about

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1. Direct investment includes the net assets in India of foreign-owned branches (representing the net claims on them by non-residents) and equity holdings of investors in the country of control and their proportionate share in the free reserves of the assets of the foreign-controlled rupee companies. Foreign investment in construction, insurance, and banking industries in India are, unless otherwise noted, excluded from the data presented in this memorandum. Book value includes net inflow after allowing for repatriation, and accounting and valuation changes.

2. Portfolio investment has been excluded from this memorandum. Portfolio investment in Indian statistics includes the ordinary shares of companies to the extent that these are held by investors in countries other than the country of control, non-resident holdings of preference shares and debentures of rupee companies, and outstanding private loans including suppliers credits. Equity investment, which makes up about 10% of so-called portfolio investment, has increased about 15% since 1948 to $133 million in 1970, with roughly two-thirds of the gain occurring after 1965. Suppliers' credits and other loans currently represent about 90% of foreign portfolio investment in India.

Table 1

India:
Direct Private Foreign Investment a/

Million US $

	31 Jul 1948	31 Dec 1955	31 Dec 1960	31 Mar 1970
Total	*443.2*	*813.1*	*1,053.8*	*926.9*
Rupee companies b/	157.9	279.0	474.6	588.0
Foreign branches	285.3	534.1	579.2	338.9

a. Book value includes net inflow after allowing for repatriation and for accounting and valuation changes (including changes because of the devaluation of the pound sterling in November 1967 and the rupee devaluation in June 1966). This table excludes foreign investment in insurance and banking.
b. Joint ventures with Indian nationals.

four-fifths of total foreign investment. Managing agencies date from the early 1800s when lenders in London insisted that the firms receiving loans be reliably managed. So great were the managing agencies' powers that companies so managed were officially considered to be foreign controlled, whatever the share of local ownership. In the aftermath of the anti-British campaign following Independence, however, the managing agencies' dependence on government favor made them vulnerable to official discrimination. Moreover, the cooperation of Indian shareholders, on which UK managing houses had built their system of control, began breaking down. As few restrictions were imposed on capital repatriations, foreign investors in plantations and export-oriented industries gradually repatriated much of their capital.

4. By 1970 the structure of foreign investment had been dramatically altered. The principal form of direct investment had become the "rupee company," or jointly owned Indian enterprise (see Table 1). Private foreign investment shifted from export-oriented industries to petroleum and manufacturing, which accounted for more than two-thirds of direct private foreign investment (see Table 2). Services' share had declined since

Table 2

India:
Direct Private Foreign Investment, by Industry a/

	31 Jul 1948	31 Mar 1970
	Percent	
Petroleum	8.4	18.7
Plantations	19.7	16.7
Mining	4.3	0.6
Manufacturing	26.8	50.8
Services	40.8	13.2
Total	*100.0*	*100.0*
	Million US $	
Total	*443.2*	*926.9*

a. Book value includes net inflow after allowing for repatriation and for accounting and valuation changes (including changes because of the devaluation of the pound sterling in November 1967 and the rupee devaluation in June 1966). This table excludes foreign investment in insurance and banking.

Independence, principally because of the demise of foreign-owned export houses. New investments in domestic trade, however, had increased sharply.

5. Net direct investment inflows have declined almost steadily since 1965 (see Table 3), principally because of accelerated capital repatriation by the foreign petroleum, plantation, and mining companies, which have been generally prohibited from expanding. During 1965-68, the net direct investment outflow from these industries totaled almost $50 million, and this outflow probably continued through 1970. New foreign investment has been slow since 1965, in part because of the sluggish performance of India's industrial sector.

Table 3

India:

Net Direct Private Foreign Investment Flows

Million US $

Year [a/]	Total	Reinvested Earnings	Other
1948-53 annual average	52.7	26.7	26.0
1954-55 annual average	31.3	48.3	-17.0
1956	52.3	41.0	11.3
1957	37.6	20.0	17.6
1958	5.0	20.6	-15.6
1959	23.1	31.7	- 8.6
1960	111.9	30.4	81.5
1961	52.7	33.2	19.5
1963	47.9	16.4	31.5
1964	47.0	20.6	26.4
1965	92.6	42.8	49.8
1966	31.9	39.5	- 7.6
1967	44.9	31.3	13.6
1968	31.0	24.2	6.8
1969	11.2	N.A.	N.A.
1970	-16.9	N.A.	N.A.

a. Calendar year through 1961, fiscal year ending 31 March of the stated year thereafter.

6. In 1970, private foreign investors held about one-fifth of India's industrial capital assets compared with over one-third at Independence. Foreign-controlled industries include the following:

Industry	Estimated Percentage of Foreign Control
Cigarettes	70+
Pharmaceuticals	80+
Rubber tires	75+
Petroleum refineries	45

Moreover, within manufacturing, private foreign investors probably control a substantial share of the assets of the aluminum, jute, tractor, petrochemical, specialized machine tools, and electrical goods industries.

Forms and Sources of Private Foreign Investment

7. Foreign firms are attracted to investing in India because it provides an easy way to sidestep import controls. The number of joint Indo-private foreign ventures, which provide a sales outlet for the foreign partner as an alternative to the virtually prohibited foreign branches, has increased sharply. Some of these ventures represent loans rather than direct investment and are little more than vehicles to sell technology, machinery, and equipment on deferred payment terms.(3) Joint ventures are concentrated in India's relatively small corporate sector but have been especially important in the newer, technologically complex, and patent-protected industries. Indo-foreign collaboration agreements are the predominant form of business organization in the manufacturing and service sectors.

8. Private foreign investment in India continues to be largely British, but the UK share has declined. US private investment in India has increased faster than that of any other country and now makes up over 15% of the total (see Table 4). According to Indian statistics, the book value of

3. The recent trend toward taking some equity participation in lieu of royalties and fees for know-how and technical assistance accounts for the increase in equity portfolio investment since 1965.

Table 4

India:
Direct Private Foreign Investment, by Country a/

	31 Jul 1948	31 Dec 1960	31 Mar 1970
		Percent	
United States	4.4	12.8	15.6
United Kingdom	80.5	78.0	72.0
Other	15.1	9.2	12.4
Total	*100.0*	*100.0*	*100.0*
		Million US $	
Total	*443.2*	*1,053.8*	*926.9*

a. Book value includes net inflow after allowing for repatriation and for accounting and valuation changes (including changes because of the devaluation of the pound sterling in November 1967 and the rupee devaluation in June 1966). This table excludes foreign investment in insurance and banking.

US direct private foreign investment is about $150 million,(4) of which about 40% is in the petroleum industry. India has received less than 2% of US private foreign investment in all less developed countries. Joint

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4. According to the US Department of Commerce, which uses a different method of valuation and classification, US direct private foreign investment in India is about $300 million. The United States, for example, counts private equity investments equivalent to 10% or more of the value of a foreign firm's ordinary shares as direct foreign investment. India, on the other hand, counts private foreign equity holdings as direct investment only if the foreign investor controls the Indian company.

ventures are the principal form of US investment, and US firms account for nearly a quarter of India's private foreign collaboration agreements. About 400 US firms are involved, about 25% of which are operating under US licensing or technical assistance agreements only.[5]

Investment Opportunities and Government Policies

9. Foreign investors can participate in certain heavy industries, designated by New Delhi as "core" or critical, and in certain medium-sized industries, provided these are located in backward areas. In addition, New Delhi, concerned about the lag in exports of new manufactures on which most of its planned gain in exports depends,[6] has welcomed foreign private investors in the export sector. Already a number of export-oriented investors are negotiating with New Delhi.

10. India has vast potentially marketable reserves of metal and mineral ores. Exploiting these reserves (excluding oil and natural gas) would increase mineral production and sharply reduce the $650 million import bill envisioned for 1975. Copper, lead, zinc, pyrite, and fluorspar reserves, for example, are known to be sufficient for the country's needs. Mineral exploitation, however, requires expertise and technology that must come from abroad. Because the development of many of these minerals is reserved for the public sector, private foreign participation depends essentially on government invitation.

11. Indian government control over private capital – domestic as well as foreign – is all-encompassing. All foreign exchange transactions must be approved, and it is this approval process that sets the tone and content for practically all private foreign ventures. A complicated licensing process and other time-consuming controls apply to both domestic and foreign businessmen. Unless New Delhi itself is sponsoring or promoting the private foreign proposal, bureaucratic delays and red tape frequently cause foreign investors to withdraw their applications and invest elsewhere.[7]

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5. The Appendix contains a partial list of US firms that have invested in India, the amount of their initial investment, and the percentage share of equity acquired in the Indian firm.

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7. The Foreign Investment Board formed in 1968 to help do away with procedural delays deals only with cases where equity investment does not exceed $2.7 million and is not above 40% of the issued equity capital.

Nevertheless, many major private foreign investors have been invited by New Delhi and their projects encouraged and pushed along by the government concessions not available to other private foreign investors.[8]

12. New Delhi has brought private foreign investors under even tighter control. In October 1970, Dinesh Singh, the Minister of Industrial Development, stipulated that foreign equity both in new undertakings and in the expansion of old ones would be restricted to 40%. New Delhi is increasing the pressure on foreign-controlled enterprises to transfer control to local personnel. Technical collaboration, but not investment, is allowed in certain industries, but provisions must now be made in these new agreements to permit the know-how to be passed on to other Indian companies. In addition, the government has reduced the period of patent protection, thus making an earlier transfer of foreign technology to Indian firms easier.[9] A new law prescribes lower royalties, and reserves for the

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8. Examples of major foreign proposals approved by the government contrary to publicly announced policies include pharmaceuticals, fertilizers, petroleum refineries, and others. New Delhi opened its fertilizer industry to private foreign participation when the US Government agreed to finance part of a large public sector fertilizer plant with the understanding that the Indian Government would permit private US investors into the fertilizer industry. Two US firms along with their Indian collaborators received the first industrial license granted to a private foreign company to manufacture fertilizer in 1961. Final agreement on this first fertilizer collaboration, however, took several years of negotiations, and the plant was not completed until late 1967 – over six years after the license was granted.

25X6

[redacted]

25X6

9. India is not a member of the International (Paris Union) Patent and Trademark Convention. Formerly, patents were granted for a period of 16 years. The new patents act, however, reduced the period of validity of all patents to 14 years and of those for pharmaceuticals, foods, and certain chemicals to seven years from the date of filing or five years from the date of issue of a patent, whichever is shorter.

government the right to use any patent. Foreign firms have been prohibited from expanding production in certain sectors reserved for small-scale firms, and restrictions governing foreign remittances have been tightened.

13. Many new joint industrial projects involve recurring foreign exchange costs for components, raw materials, and other industrial requirements, and New Delhi wants to buy these competitively rather than exclusively from the foreign partners. Thus the government has announced that foreign collaboration will be permitted only if it meets a critical need and does not inhibit the maximum utilization of domestic know-how and services. Foreign private investment is supposed to be rigidly screened and prohibited where indigenous efforts can provide the same services.

14. In line with its tighter restrictions on foreign investment, New Delhi has demanded that a number of companies reduce their equity as a condition for New Delhi's approval of the firms' expansion proposals. Several companies have since begun selling a portion of their equity. The foreign-owned petroleum industry, which has repeatedly been criticized for one or another reason, recently came under increasing attack because its import prices for crude oil were higher than the level agreed to early this year at the Teheran settlement.[10] The government is considering either (a) nationalizing the oil companies, (b) securing equity participation, or (c) revising the existing refinery agreements to permit New Delhi greater latitude in importing crude oil. Anticipating some adverse action by the government, the petroleum companies are repatriating capital.

15. Despite India's discouraging policies, investors continue to seek some kind of a foothold. Numerous private foreign investor groups from the principal developed countries are interested in using cheap Indian labor to manufacture (a) bulk components and sub-assemblies for export and (b) products filling technological and production gaps for sale within India itself. Several collaboration agreements in fishing, the machine tool industry, and export trade (Sears and Roebuck), for example, have been recently concluded.

16. Foreign firms are increasingly offering to collaborate on a minority basis, some even with the government. Phillips Petroleum and the American International Oil Company both, for example, took minority interests with the government in petroleum refineries that began operating in 1966 and 1969, respectively. A wide variety of products, including almost everything from manufacturing farm tractors to sophisticated communication and electronic equipment, are being discussed. The

25X1

government is now actively negotiating with four potential private foreign collaborators to build on a minority basis an automobile factory in the public sector.(11) In addition, Mitsubishi of Japan is exploring trade and investment prospects with Indian officials. Japan is more interested in collaboration than investment and wants to organize small export-oriented industries, with technology being Tokyo's greatest contribution. Japanese investors are particularly interested in petrochemicals and mining collaborations and cited the stabilized domestic political situation in India as making the investment climate there "quite normal and promising." Government regulations, however, continued to be cited as a major problem. Finally, recent private US-Indian negotiations have included hotels, automobiles, rubber goods, plastics, computers, fertilizer, machine tools, petrochemicals, dry cell batteries, railway equipment, tire-making machinery, specialized defense industry items, and petroleum.

Prospects

17. Although New Delhi will continue, for political reasons, to denounce private foreign investment, it is likely to encourage, as minority partners, investors offering new technology and know-how. Foreign investment in joint ventures has almost quadrupled since Independence. Moreover, the government will make concessions when the country needs certain technology. Past concessions to potential investors have included relinquishing management control for a limited period and accepting some new foreign investors as majority stockholders.

18. Foreign investor interest in India will be attracted by the relatively stable government, the large and expanding domestic market, reasonably liberal provisions for profit repatriation, virtually no record of nationalizing foreign industrial companies, and a large trainable and relatively inexpensive labor supply, including both skilled workers and managerial talent. Moreover, investor attitudes are changing. In contrast to earlier periods when India's socialism scared away investors, many now are quite willing to join even the Indian Government in joint ventures. Nevertheless, India has nowhere near what foreign investors expect in terms of simplification of industrial licensing and other related procedures; and, whereas Indian businessmen have no option but to put up with New Delhi's bureaucracy, foreign investors can look elsewhere.

11. In the early 1950s the Ford Motor Company would not agree to New Delhi's demands that the company include a minor Indian participation to remain in India. In contrast, Ford is now negotiating in competition with the Japanese, French, and Italians to build a car in the public sector.

19. Although joint ventures are likely to increase, most foreign investors will hold a minority share. Also, at the government's urging, many existing foreign-controlled firms will reduce their ownership to a minority by selling off equity. Foreign-owned petroleum refineries and trading organizations are likely to continue disinvesting, as the government clearly intends curbing their operations. Finally, new petroleum policies where New Delhi either takes majority ownership or nationalizes the private foreign refineries – now under consideration – will also sharply increase capital repatriation.

APPENDIX

Selected US-Indian Collaboration Agreements

There are over 400 US firms providing technical and financial assistance to India. The names of all these firms and the amount of their equity investment are not available. A selected list of the principal companies appearing in annual publications, *A Directory of Foreign Collaboration in India*, published by Indian Overseas Publications in Delhi, however, are given in Tables 5 and 6.

Table 5

Selected US-Indian Collaboration Agreements Involving Equity Participation

US Firm	Initial Equity Participation: Thousand US $	Per-cent	Product or Process
Caltex	9,450	100	Refinery
Esso Standard Eastern	5,166	60	Refinery
Union Carbide	4,725	75	Non-electrical machinery
Pfizer Corp.	4,190	75	Pharmaceuticals
Kaiser Alumium	3,369	19	Aluminum
Goodyear	3,366	63	Tire and rubber
Merck and Co., Inc.	2,646	60	Pharmaceuticals
Firestone Tire and Rubber	2,363	25	Tire and rubber
Sperry Rand	2,321	77	Machinery
Firestone Tire and Rubber	2,310	100	Tire and rubber
Merck and Co., Inc.	2,268	60	Pharmaceuticals
Sperry Rand	2,264	77	Machinery
Parke Davis and Co.	1,837	83	Pharmaceuticals
Rohm Hass Co.	1,680	40	Machinery
Cummins Engine Co.	1,575	50	Engines
Corning Glass	1,544	49	Glass
Parsons and Whittemore	1,323	35	Paper
United Carbon	1,302	40	Carbon
California Chemical Co.	1,212	7	Fertilizers
International Minerals and Chemicals Corp.	1,088	6	Fertilizers
Napco Industries, Inc.	998	38	Gears
Abbey Etna Machine Co.	988	39	Steel tubes
American Cyanamide Co.	955	65	Pharmaceuticals

Table 5

Selected US-Indian Collaboration
Agreements Involving Equity Participation
(Continued)

US Firm	Initial Equity Participation Thousand US $	Initial Equity Participation Per-cent	Product or Process
General Electric	892	50	Electrical equipment
Sylvania	756	45	Electrical products
Otis Elevator	734	70	Machinery
B. F. Goodrich	721	23	Chemicals and plastics
Universal American Corp.	635	29	Precision bearings
Sperry Rand Corp.	536	50	Industrial
Great Lakes Carbon Corp.	525	20	Graphite
Textron Industries	525	33	Industrial
Mansfield Tire and Rubber	525	25	Tire and rubber
Revere Copper and Brass	525	33	Metals
Air Products and Chemicals	524	16	Oxygen
Johnson and Johnson	483	64	Pharmaceuticals
Great Lakes Carbon	336	32	Carbon
Frick Co.	321	61	Industrial refrigeration
Borg Warner	315	50	Industrial
Colgate Palmolive	315	100	Perfume and cosmetics
Mississippi Glass Co.	252	20	Wired glass
Dayton Rubber	210	5	Tires
Abbot Laboratories	21	100	Pharmaceuticals

Table 6

Selected US-Indian Collaboration Agreements Involving Only Technical Participation

US Firm	Product or Process
Westinghouse Electric	Refrigeration
Kaiser Aluminum Technical Service	Aluminum
Allison L. Boyle & Associates	Forges
Universal Oil Products Co.	Polymers
Milspring Overseas Corp.	Paper products
Transoceanic Engineers	Chemicals
Stone & Webster Engineering Corp.	Chemicals
John Van Der Valk & Associates	Fertilizer
Fairbanks Morse & Co.	Turbine pumps
Caterpillar Tractors	Spare parts for tractors
University Loud Speakers Inc.	Loud speakers
James F. Walsh	Citric acid
Carrier Corp.	Refrigeration and air conditioning
Clark Equipment International	Forklift trucks
Gabriel Co.	Shock absorbers

Table 6

Selected US-Indian Collaboration Agreements
Involving Only Technical Participation
(Continued)

US Firm	Product of Process
Cluett, Peabody & Co.	"Sanforized" cloth
Pacific Welding, Alloys Mfg. Co.	Welding electrodes and rods
Landis Machine Co.	Industrial machinery
Sparkler Mfg. Co.	Filters
Kaiser Industries Corp.	Cement
RCA	Radios and movie projectors
Foster D. Shell Inc.	Dyes
Eimco Corp.	Sugarcane mud filters
Standard Ore & Alloys Corp.	Tungsten filaments and coils
Sawyer's Inc.	View Master reels and accessories
Harnisehfeger Corp.	Excavators
Raytheon & Co.	Semiconductors
Allis Chalmers Mfg. Co.	Earthmoving equipment
Western Electric Co., Inc.	Transistors
Eastman-Kodak Co.	Dry vitamin A

Table 6

Selected US-Indian Collaboration Agreements
Involving Only Technical Participation
(Continued)

US Firms	Product of Process
Hillor Aircraft Corp.	Crop dusting
Union Carbide Corp.	Cinema arc carbons
Corning Glass	Glassware
Allied Chemical	Fertilizer
Pittsburgh Plate Glass	Sheetglass
E.I. DuPont de Nemours	Synthetic camphor
Diamond Chain Inc.	Bicycle and industrial chains
Kimberly Clark Corp.	Paper
Singer Mfg. Co.	Sewing machine needles
H.W. Butterworth & Sons	Machinery spare parts
Hammond Iron Works	Floating roof tanks
Phillips Petroleum	Carbon black
Kelvinator International	Refrigeration
Squibb Co.	Pharmaceuticals
Allis Chalmers	Earthmoving equipment
Southern Chemical Cotton Co.	Rayon grade pulp
Clevite Corporation	Transistors

Table 6

Selected US-Indian Collaboration Agreements
Involving Only Technical Participation
(Continued)

US Firms	Product of Process
Tecumseh Products	Compressors
Norton Company	Grinding machines
Air Products, Inc.	Industrial gases
Rockwell and Co.	Insulating paper
Olin Mathieson Chem. Corp.	Pharmaceuticals
American Cyanamide Co.	Pesticides
General Electric Co.	Electric lamps
International Paper Co.	Paper, newsprint, and rayon grade pulp
United States Rubber Co.	Tires and tubes
Hastings Manufacturing Co.	Automobile parts
Revere Copper and Brass	Copper brass alloys
Draper Corp.	Automatic looms
Stewart Warner Corp.	Industrial and automotive equipment
Glidden Co.	Synthetic camphor
American Air Filters	Industrial machinery
Minnesota Mining and Mfg.	Insulation materials

Table 6

Selected US-Indian Collaboration Agreements
Involving Only Technical Participation
(Continued)

US Firms	Product of Process
Lock Joint Pipe Co.	Prestressed concrete pipes
International Harvestor	Tractors
Monarch Machine Tool Co.	Lathes
Gates Rubber Co.	Tires and tubes
Johns Manville Corp.	Mineral wool
Michle, Goss, Dexter Inc.	Printing machinery
Brown and Root Inc.	Carbon black
Johnston Pump Co.	Pumps
Kropp Forge Co.	Steel forgings
Sheffield Corp.	Gauges
Warner Lambert Pharmaceutical Co.	Pharmaceuticals
Joy Manufacturing Co.	Diamond core drills
McNally Pittsburgh Mfg. Corp.	Coal washeries and cement production
Standard Tool Co.	Plastic injection moulding machines
McKay Machine Co.	Steel tubes
Drew Chemical Corp.	Nickel catalyst

Table 6

Selected US-Indian Collaboration Agreements
Involving Only Technical Participation
(Continued)

US Firms	Product of Process
Avnet Shaw Co.	Ceramic precision casting units
Sun Chemicals	Paints and varnishes
Bendix Westinghouse	Airbrake equipment
Chicago Blower Corp.	Industrial blowers
A.C.F. Industries	Automotive parts
Simpson Electric Co.	Testing equipment
Struthers Wells International Corp.	Chemical machinery
Purolator Products Inc.	Industrial filtration equipment
Hercules Powder Co.	Pine chemicals
Sperry Rand Corp.	Typewriters
Cutler-Hammer Corp.	Electrical equipment
Armour and Co.	Fertilizer
General Motors Corp.	Roadbuilding machinery
Eli Lilly International Corp.	Pharmaceuticals
Staufer Chemical Corp.	Fertilizers
Western States Machine Co.	Sugar machinery parts